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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 596

TRADESMENS NATIONAL BANK OF OKLAHOMA CITY, A BANKING CORPORATION,

Appellant,

vs.

THE OKLAHOMA TAX COMMISSION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF OKLAHOMA.

BRIEF OF APPELLANT.

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THE OKLAHOMA TAX COMMISSION.

APPEAL FROM THE SUPREME COURT OF OKLAHOMA.

BRIEF OF APPELLANT TRADESMENS NATIONAL BANK OF OKLAHOMA CITY, A BANKING CORPORATION.

This is an appeal from the decision of the Oklahoma Supreme Court, which opinion is reported in 95 Pac. (2d) 121 (not yet officially reported in the Oklahoma Reports). The opinion refers to a companion case, *First National Bank of El Reno* v. *The Oklahoma Tax Commission*, reported in 90 Pac. (2d) 438, 185 Okla. 98.

The grounds on which the jurisdiction of this Court is invoked is under Judicial Code, Section 237, as Amended, 28 U. S. C. A. 344. The Legislature of the State of Okla-

homa enacted Article 6, Chapter 66, Acts of the Fifteenth Legislature, being Session Laws of 1935, page 286, which Act, known as the 1935 State Income Tax Law, sought to impose taxes on the income of national banks, which income expressly included income from bonds of the United States Government and its subsidiaries, which bonds were expressly made non-taxable as to principal and income under the provisions of Congress authorizing them. The Bank paid such income taxes under protest and filed suit for their recovery in the manner and time provided for in said Act, and based its right to recover said taxes so paid under protest on the ground that said taxes so imposed by said Act, which Act was in violation of the Constitution of the United States, as being:

(a) A denial of equal protection of the law;

(b) A denial of due process of law;

(c) A denial of the inherent constitutional power of Congress to borrow money on the credit of the United States;

(d) A violation of Section 5219, Revised Statutes of the United States;

(e) The upholding of a State Act which impaired the obligation of a contract;

(f) The upholding of a State Act which was enacted solely to tax income from obligations of the United States which by previous Act prior to the enactment of 1935, said obligations were free from such taxation.

Assigned Errors Intended to be Urged.

(1) The statute of the State of Oklahoma, to-wit: 1935 Income Tax Law and more particularly Sections 16, 17, 18 and 19 thereof, is unconstitutional and void as repugnant to paragraph 1 of Section 10 of Article I of the Constitution in

that it impairs the obligation of existing contracts of the appellant.

(2) The aforesaid Act of the State of Oklahoma is unconstitutional and repugnant to Section 1 of the Fourteenth Amendment of the Constitution of the United States in that it deprives the appellant of its liberty and property without due process of law.

(3) The aforesaid statute of the State of Oklahoma is unconstitutional and repugnant to Section 1 of the Fourteenth Amendment of the Constitution of the United States in that it deprives the appellant of the equal protection of the laws.

(4) The aforesaid statute of the State of Oklahoma is unconstitutional and repugnant to Section 5219, Revised Statutes of the United States.

(5) The said statute of the State of Oklahoma is unconstitutional and repugnant in that it was enacted for the express and specific purpose of taxing income from tax-exempt obligations of the United States, as the predecessor statute, being enacted in 1933, is exactly similar to the 1935 Act except that the 1933 Act exempted such income of obligations of the United States from taxation, while the 1935 Act had as its only change the inclusion of such income as being taxable.

(6) The said statute of 1935, by virtue of which the State Tax Commission assessed 6% taxes against the income from instrumentalities of the United States Government, is discriminatory as against national banks because the statute specifically provides that the taxes on Federal instrumentalities can be levied only against banks and not other corporations or individuals. Other corporations owning Government bonds under the statutes are allowed to deduct from their gross income all income derived from the interest on

obligations of the United States and its possessions, or on securities issued under authority of an Act of Congress, the interest from said securities being specifically non-taxable; but Sections 8 (8), (c) and 18 (b) of said legislative enactment specifically provides that this bank and all banks in Oklahoma are denied this exemption and are compelled to pay a tax upon the following:

> "Interest upon the obligations of the United States, or its possessions, or upon securities issued under the authority of an Act of Congress, the income from which is tax free."

(7) As a result of the Oklahoma Statutes of 1935, cited *supra*, this bank and all other banks are compelled to pay taxes over and above and in addition to the tax imposed on any and all other idividuals or corporations in this State, including individuals or corporations engaged in competition with said bank, such as building and loan associations, partnerships and persons who are engaged in the business of loaning money and in addition to it being illegal by virtue of Section 8 of Article 1 of the Fourteenth Amendment of the Constitution of the United States, it is contrary to Section 5219 of the Revised Statutes of the United States; and in addition to this, it is violative of Sections 7 and 15 of Article II, and Section 5 of Article X of the Constitution of Oklahoma, and Section 12370, Oklahoma Statutes 1931.

ARGUMENT.

(1) The statute of the State of Oklahoma, to-wit: 1935 Income Tax Law, and more particularly Sections 16, 17, 18 and 19 thereof, is unconstitutional and void as repugnant to paragraph 1 of Section 10 of Article 1 of the Constitution of the United States in that it impairs the obligation of existing contracts of the appellant.

The Act of Congress authorizing the issuance of the bonds, the income of which is involved herein, has the fol-

lowing language, or an almost duplication thereof, and this statement is further reproduced on the bonds themselves:

> "This Bond is issued under the authority of and in accordance with the provisions of the Federal Farm Mortgage Corporation Act approved January 31, 1934, as amended, which provides that Bonds issued thereunder shall be deemed and held to be instrumentalities of the Government of the United States, and that as such they and the income derived therefrom shall be exempt from Federal, State, Municipal, and local taxation (except surtaxes, estate, inheritance and gift taxes)."

The Act of the Oklahoma Legislature as shown in Appendix A hereto, imposes a tax directly on the income from these obligations.

This bank and all other purchasers acquired these bonds under the express terms, conditions and limitations as provided in the Act of Congress authorizing them and as reproduced on the bonds themselves. This was a contractual obligation and the Act of the Oklahoma Legislature purports to change, alter and vary the terms of the contract between the holder and owner of these bonds and the authority issuing them. This cannot be done, as such Act impairs the obligations of a contract.

> "A state statute (Mass. Gen. Laws, Chap. 63, as amended) which purports to impose an excise tax upon domestic business corporations for the privilege of doing business, measured by their net income derived from business carried on within the state, and which provides that such net income shall include 'all interest and dividends * * * except dividends on shares of stock of corporations organized under the laws of the commonwealth and dividends in liquidation paid from capital,' operates to impose a tax upon county and municipal bonds, and is, therefore, void as impairing the obli-

gation of the statutory contract of the state by which such bonds are made exempt from state taxation."

MacAllen Company v. *Commonwealth of Massachusetts*, 65 A. L. R. 866, 279 U. S. 620, 73 L. Ed. 874, 49 Sup. Ct. Rep. 432.

This same matter was in issue and directly passed upon by the Court of Appeals of the District of Columbia in the case of *District of Columbia* v. *Riggs National Bank*, 30 F. (2d) 873 (1929). An Act of Congress provided that every national bank in the District of Columbia should pay six per cent on gross earnings, and further provided that the tax levied should be in lieu of all other taxes upon personal property. That is the same provision in the 1935 Oklahoma Income Tax Law. The bank paid on gross earnings, but refused to pay six per cent on that portion of gross earnings which was received as interest on United States Government bonds and other evidences of public debt, which by the terms of the law under which they were issued were made tax exempt. We have the same state of facts here. The court relied upon the case of *Northwestern Mutual Life Insurance Co.* v. *Wisconsin, supra*, and stated:

"The controlling point in the decision of the Court in this case is that a license, franchise, or privilege tax, measured by gross income, gross earnings or gross receipts, which are partly derived from United States bonds, amounts to taxation on the bonds themselves, and it was for this reason that the court held that the state exceeded its power and that the tax was to that extent void. The District tax law is not different from the law of Wisconsin, as set out in the opinion of the court in the second Wisconsin case. There, as here, Wisconsin contended that it was a privilege, franchise, or license tax. The Supreme Court, at page 139 (148 S. Ct. 56), referring to its decision in the former Wisconsin case, said: 'Speaking there of this same statute we did declare: "The tax in question is, therefore, not only one for the privilege of doing life insurance busi-

ness within the state, but is in effect a commutation tax, levied by the state in place of all other taxation upon the personal property of the company in the State of Wisconsin."

In the fourth syllabus the Court said:

"Act April 24, 1917, § 1, 31 U. S. C. A. § 746, and other acts exempting both principal and interest of bonds issued thereunder from all taxation, except estate or inheritance taxes, imposed by the United States, its possessions, or any state or local taxing authority, apply to the District of Columbia, as well as the states, and place a limitation on Congress, as well as state Legislatures."

(2) The aforesaid Act of the State of Oklahoma is unconstitutional and repugnant to Section 1 of the Fourteenth Amendment of the Constitution of the United States in that it deprives the appellant of its liberty and property without due process of law.

(3) The aforesaid statute of the State of Oklahoma is unconstitutional and repugnant to Section 1 of the Fourteenth Amendment of the Constitution of the United States in that it deprives the appellant of the equal protection of the laws.

It will be noted from a reading of the Oklahoma Income Tax Law of 1935 shown in Appendix A hereof, that individuals and other corporations in the State of Oklahoma are exempt from the terms of said State Income Tax Law insofar as income from obligations of the United States is concerned. In other words, competitive individuals and corporations are treated in one manner and national banks in another. This is patently discriminatory and a denial of due process and equal protection of the laws under the Fourteenth Amendment to the Constitution of the United States.

"In determining constitutionality of State tax law, court must consider, not only legislative recitals, but true operation on basis of practical results.

"Thus when the state law declares that the tax is imposed 'for the privilege of exercising corporate franchise within state,' such recital is not conclusive in determining whether the statute offends against the Constitution, but the court must also consider the true operation and effect of the law, which must be dealt with on the basis of the practical results which follow its operation.

"Tax measured by 'net income,' denominated privilege tax on financial corporation, held in effect tax on net income as regards equal protection clause (Laws 1929, p. 380; Const. U. S. Amend. 14 § 1).

"Laws 1929, p. 380, which imposes a tax on banks and financial corporations measured by their 'net income,' as defined by the act, recites that the tax is imposed 'for the privilege of exercising its corporate franchise within this state.' However, despite the legislative declaration, the practical operation of the law is to lay a tax on the net income of corporations. It is not peculiarly applicable to corporations as taxes on capital stock or franchises. It is levied on, and is to be considered and tested as, a tax on net income.

"State tax measured by net income, including income from national tax-exempt obligations, held invalid as contravening federal laws (Laws 1929, p. 380).

"Laws 1929, p. 380, imposed on banks and financial corporations a tax measured by their net income, but made no provision that income derived from federal government securities, which by the laws of the United States are exempt from state taxation, should be excluded in arriving at the net income which was to form the basis for the tax.

"State law imposing tax, measured by net income on banks and financial corporations and not on individuals, held unconstitutional as denial of equal protection (Laws 1929, p. 380; Const. U. S. Amend. 14 § 1).

"Laws 1929, p. 380, imposed a tax measured by net income, as defined by the act, on national banks, banks

and financial corporations, which term was defined as including savings and loan associations. As to banks other than national banking associations, and as to financial corporations, the act declared that the tax was imposed 'for the privilege of exercising * * * corporate franchise within this state,' but, despite this legislative declaration, the practical operation of the statute was a tax on net income which, since it was not levied on individuals, or businesses other than banks and financial corporations, injuriously affected savings and loan associations in competition with individuals and others not subject to the tax."

Aberdeen Savings & Loan Association v. *Chase*, 289 Pac. 536 (Wash.).

(4) The said statute of the State of Oklahoma is unconstitutional and repugnant in that it was enacted for the express and specific purpose of taxing income from tax-exempt obligations of the United States, as the predecessor statute, being enacted in 1933, is exactly similar to the 1935 Act except that the 1933 Act exempted such income of obligations of the United States from taxation, while the 1935 Act had as its only change the inclusion of such income as being taxable.

By referring to the terms of the 1933 Income Tax Law of Oklahoma, shown as Appendix "B" hereof, it will be noted that under its terms, income from obligations of the United States was expressly exempted from the terms and provisions of that income tax law. The Income Tax Law of 1935, shown as Appendix "A" hereof, and being enacted for the express purpose of amending and supplanting the terms and provisions as regards national banks, changed the terms and provisions of the 1933 law in one, and only one, particular, as regards income to national banks. It expressly includes as taxable income to national banks such income received by national banks from obligations of the

United States. Such income was expressly exempted in the 1933 law and thus the sole and only purpose for the enactment under the 1935 law was to tax income which was heretofore non-taxable. *McAllen* v. *Commonwealth of Massachusetts,* 279 U. S. 620, 73 L. Ed. 874, 49 S. Ct. 432.

"In the consideration of such legislation, the controlling principle, constantly to be borne in mind, is that the state cannot tax the instrumentalities or bonds of the United States, or, what is the same thing, the income derived therefrom, directly or indirectly; that is to say, it cannot tax *them* in any form. Words which, literally considered, import a tax upon something else, —a tax, for example, as here, upon the privilege of doing business measured in part by the amount of non-taxable interest received,—may nevertheless, be adjudged to lay a tax upon the interest, if that purpose be fairly inferable from a consideration of the history, the surrounding circumstances, or the statute itself considered in all its parts. See Home Sav. Bank *v.* Des. Moines, 205 U. S. 503, 510, 521, 51 L. Ed. 901, 906, 911, 27 Sup. Ct. Rep. 571.

"On the one hand, the state is at liberty to tax a corporation with respect to the doing of its business. On the other hand, the state cannot tax the income of the corporation derived from nontaxable securities. It necessarily follows that the legislature may not, by an artful use of words, deprive this court of its authority to look beyond the words to the real legislative purpose. And the power and the duty of the court to do so is of great practical importance. For when the aim of the legislature is simply to tax the former, it is less likely to impose an injurious burden upon the latter than when the aim is directed primarily against the latter. See Galveston, H. & S. A. R. Co. *v.* Texas, *supra* (210 U. S. p. 227, 52 L. Ed. 1037, 28 Sup. Ct. Rep. 638)."

"In the present case, it appears that the original statute exempted from consideration as a part of the measure of the tax all interest upon the nontaxable

securities. The amended act now in force has the effect of repealing this original provision and imposing a burden upon the securities from which, by express language, they had theretofore been free. This was a distinct change of policy on the part of the commonwealth, adopted, as though it had been so declared in precise words, for the very purpose of subjecting these securities pro tanta to the burden of the tax."

MacAllen Company v. *Commonwealth of Massachusetts*, 65 A. L. R. 866, 873, 874, 279 U. S. 620, 73 L. Ed. 874, 49 Sup. Ct. Rep. 432.

(5) The effect of the decision upholding the Act of the 1935 Legislature of the State of Oklahoma is derogatory of the power of Congress to borrow money on the credit of the United States. It is elementary that under our dual system of government, that the United States, acting through Congress, necessarily has the power and authority to borrow money on its credit. That is essential for the ability of both the Federal Government and the State Government to properly function; and any restriction on this power necessarily is unconstitutional.

"A State tax, however small, on securities of the national government or on interest derived therefrom, is invalid as interfering or tending to interfere with power of general government to borrow money on credit of the United States.

"Constitutional provisions, whether operating by way of grant or limitation, are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which seeks to accomplish indirectly that which cannot be done directly.

"A tax ostensibly on corporate privilege of doing business, measured in part by amount of nontaxable interest received, may be adjudged to lay a tax on the interest, if that purpose be fairly inferable from a consideration of the statute, its history, and surrounding circumstances.

"The distinction pointed out in these cases is between an attempt to tax the property or income as such and to measure a legitimate tax upon the privileges involved in the use thereof. It is implicit in all that the thing taxed in form was in fact and reality the subject aimed at, and that any burden put upon the nontaxable subject by its use as a measure of value was fortuitous and incidental.

"The aphorism of Chief Justice Marshall in McCulloch *v.* Maryland, 4 Wheat. 316, 431 (4 L. Ed. 579), that 'The power to tax involves the power to destroy', has frequently been reiterated by this Court. The principle, of course, is important only where the tax is sought to be imposed upon a nontaxable subject; or, as said in Knowlton *v.* Moore, 178 U. S. 41, 60 S. Ct. 747, 755 (44 L. Ed. 969,) ' * * * the power to destroy which may be the consequence of taxation is a reason why the right to tax should be confined to subject which may be lawfully embraced therein, even although it happens that in some particular instance no great harm may be caused by the exercise of the tax authority as a subject which is beyond its scope'. Not only may the power to tax be exercised oppressively, but for one government—state or national—to lay a tax upon the instrumentalities or securities of the other is derogatory to the latter's dignity, subversive to its powers and repugnant to its paramount authority. See California *v.* Central P. R. R. Co., 127 U. S. 1, 41 S. Ct. 1073 (32 L. Ed. 150).

"The fact that a tax ostensibly laid upon a taxable subject is to be measured by the value of a non-taxable subject at once suggests the probability that it was the latter rather than the former that the law-maker sought to reach. If inquiry discloses persuasive grounds for the conclusion that such is the real purpose and effect of the legislation, the tax cannot be upheld without subverting the well-established rule that ' * * * what cannot be done directly because of constitutional restrictions' cannot be accomplished indirectly by legislation which accomplishes the same result. * * * Constitutional provisions whether oper-

ating by way of grant or limitation are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which, though not in terms trespassing on the letter, yet in substance and effect destroy the grant or limitation.' Fairbank *v.* United States, 181 U. S. 283, 294, 300, 21 S. Ct. 648, 653 (45 L. Ed. 862)."

McAllen v. *Commonwealth of Massachusetts*, 279 U. S. 620, 73 L. Ed. 874, 49 S. Ct. 432.

"State law, taxing corporate dividends, in proportion to which corporate income was not assessed, obviously passed for purpose of imposing a tax on United States bonds, held unconstitutional.

"It is a familiar principle that conduct which in usual situations the law protects may become unlawful when part of a scheme to reach a prohibited result. If the avowed purpose of self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail even if but for its purpose or special operation it would be perfectly good.

"A tax very well might be upheld as against any causal effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack upon their immunity when they are its obvious aims. In such a case the court must consider the public welfare rather than the artifices contrived for private convenience and must look at the facts. See Home Insurance Co. of New York *v.* New York, 134 U. S. 594, 598, 10 S. Ct. 593, 33 L. Ed. 1025; Gillespie *v.* Oklahoma, 257 U. S. 501, 505, 42 S. Ct. 171, 66 L. Ed. 338; United States Grain Corporation *v.* Phillips, 261 U. S. 106, 113, 43 S. Ct. 283, 67 L. Ed. 552."

Miller v. *City of Milwaukee*, 272 U. S. 713, 47 S. Ct. 280, 71 L. Ed. 487.

"St. Wis. 1923, No. 76, 34 (St. 1919, No. 1211-35; St. 1917, No. 41.32), insofar as it imposes charges against life insurance companies of 3 percent on gross income from all sources, except rents of land on which it paid taxes and premiums collected, held invalid to that extent, as imposing direct charge on interest derived from United States bonds.

"Bonds of United States are beyond taxing power of States, neither can valid tax be laid on income arising therefrom.

"Counsel for the state maintain that the effect of section 76.34 is to impose upon domestic insurance companies a privilege or franchise tax, and not one on property or income; that no charge is laid upon bonds of the United States, but the fee exacted is for granted privileges, including exemption from personal property taxation and right to do business; that the state may require domestic corporations to pay privilege, franchise or license taxes measured by gross income, although partly derived from United States bonds; and that in no proper sense can the challenged tax be regarded as one directly imposed upon gross income.

"They also suggest that this court has interpreted the statute and pointed out its real nature. Northwestern Mutual Life Ins. Co. *v.* State of Wisconsin, 247 U. S. 132, 137, 38 S. Ct. 444, 62 L. Ed. 1025. Speaking there of this same statute we did declare:

"The tax in question is, therefore, not only one for the privilege of doing life insurance business within the State, but is in effect a commutation tax, levied by the State in place of all other taxation upon the personal property of the company in the State of Wisconsin.

"But no question was then raised concerning taxation of income derived from United States bonds. The point now presented was not involved.

"It cannot be denied (and denial is not attempted) that bonds of the United States are beyond the taxing power of the States. Home Savings Bank *v.* City of Des Moines, 205 U. S. 503, 509, 27 S. Ct. 571, 51 L. Ed.

901; Farmers & Merchants Bank *v.* Minnesota, 232 U. S. 516, 34 S. Ct. 354, 54 L. Ed. 706; and First National Bank *v.* Anderson, 269 U. S. 341, 347, 46 S. Ct. 135, 70 L. Ed. 295. Certainly since Gillespie *v.* Oklahoma, 257 U. S. 501, 505, 42 S. Ct. 171, 66 L. Ed. 338, it has been the settled doctrine here that where the principal is absolutely immune, no valid tax can be laid upon income arising therefrom. To tax this would amount practically to laying a burden on the exempted principal. Accordingly if the challenged act, whatever called really imposes a direct charge upon interest derived from United States bonds, it is pro tanto void.

"The fundamental question often presented in cases similar to these, is whether by the true construction of the statute the assessment must be regarded as a tax upon property or one on privileges or franchise of the corporation. Society for Savings *v.* Coite, 6 Wall. 594, 18 L. Ed. 897; Home Insurance Co. *v.* New York, 134 U. S. 594, 10 S. Ct. 593, 33 L. Ed. 1025.

"Here the statute undertook to impose a charge of 3 per cent upon every dollar of interest received by the company from United States bonds. So much, in any event, the State took from these very receipts. This amounts, we think, to an imposition upon the bonds themselves and goes beyond the power of the State."

Northwestern Mutual Life Ins. Co. v. *State of Wisconsin*, 275 U. S. 136, 72 L. Ed. 202, 148 S. Ct. 55.

(6) The aforesaid statute of the State of Oklahoma is unconstitutional and repugnant to Section 5219, Revised Statutes of the United States.

The letter and spirit of Section 5219 Revised Statutes of the United States seeks to place national banks on an equality and parity with competitive businesses. It permits taxation under certain terms and conditions, but it is not intended thereby to permit the States to discriminate against national banks, nor is it intended by Congress to permit

States to levy direct taxes against these banking institutions; and no State may do indirectly what it cannot do directly. The State of Oklahoma passed an income tax law and now seeks to sustain its authority to tax national banks thereunder by asserting that the tax so imposed thereby is an excise, privilege or franchise tax, which we submit is contrary to the letter and spirit of Revised Statutes 5219.

"In determining constitutionality of State tax law, court must consider, not only legislative recitals, but true operation on basis of practical results.

"Thus when the State law declares that the tax is imposed 'for the privilege of exercising corporate franchise within State', such recital is not conclusive in determining whether the statute offends against the Constitution, but the court must also consider the true operation and effect of the law, which must be dealt with on the basis of the practical results which follow its operation.

"Tax measured by 'net income', denominated privilege tax on financial corporation, held in effect tax on net income as regards equal protection clause (Laws 1929, p. 380; Const. U. S. Amend 14 § 1).

"Laws 1929, p. 380, which imposes a tax on banks and financial corporations measured by their 'net income' as defined by the act, recites that the tax is imposed 'for the privilege of exercising its corporate franchise within this State'. However, despite the legislative declaration, the practical operation of the law is to lay a tax on the net income of corporations. It is not peculiarly applicable to corporations as are taxes on capital stock or franchises. It is levied on, and is to be considered and tested as, a tax on net income.

"State tax measured by net income, including income from national tax-exempt obligations, held invalid as contravening federal laws (Laws 1929 p. 380).

"Laws 1929, p. 380, imposed on banks and financial corporations a tax measured by their net income, but made no provision that income derived from federal

government securities, which by the laws of the United States are exempt from state taxation, should be excluded in arriving at net income which was to form the basis for the tax.

"State law imposing tax, measured by net income on banks and financial corporations and not on individuals, held unconstitutional as denial of equal protection (Laws 1929, p. 380; Const. U. S. Amend. 14 § 1).

"Laws 1929, p. 380, imposed a tax measured by net income, as defined by the act, on national banks, banks and financial corporations, which term was defined as including savings and loan associations. As to banks other than national banking associations, and as to financial corporations, the act declared that the tax was imposed 'for the — of exercising * * * corporate franchise within this state', but, despite this legislative declaration, the practical operation of the statute was a tax on net income which, since it was not levied on individuals, or businesses other than banks and financial corporations, injuriously affected savings and loan associations in competition with individuals and others not subject to the tax."

Aberdeen Savings & Loan Association v. *Chase*, 289 Pac. 536 (Wash.).

See also *Bank of Fairfield* v. *Spokane County*, 22 Pac. (2d) 646 (1933), (Wash.)

The appellee necessarily relies upon three cases as sustaining the right to impose this tax. The first of these cases is *Flint* v. *Stone-Tracy Company* (1910), 220 U. S. 107, 55 L. Ed. 389, 31 S. Ct. 342, wherein this court held that a Federal corporation tax in the nature of an excise tax upon the privilege of doing business in a corporate capacity equivalent to one per cent of the entire net income over a certain period was held not to be invalid because it did not except from its operation the income from municipal bonds and other non-taxable securities * * * since such was

not a tax upon the property as such but a tax upon the privileges involved in the use of such property.

Of this case, this court commented in *MacAllen* v. *Massachusetts, supra,* as follows:

> "The court below predicates its decision upon a series of decisions of which Flint *v.* Stone Tracy Co., 220 U. S. 107, 163-165, 55 L. Ed. 389, 418, 419, 31 Sup. Ct. Rep. 342, Ann. Cas. 1912B, 1312, is the extreme example, holding that a tax lawfully imposed upon the exercise of corporate privileges within the taxing power may be measured by income from the property of the corporation although a part of such income is derived from nontaxable property. See also Home Ins. Co. *v.* New York, 134 U. S. 594, 33 L. Ed. 1025, 10 Sup. Ct. Rep. 593; Society for Savings *v.* Coite, 6 Wall. 594, 18 L. Ed. 897; Provident Inst. *v.* Massachusetts, 6 Wall. 611, 18 L. Ed. 907. The distinction pointed out in these cases is between an attempt to tax the property or income as such and to measure a legitimate tax upon the privileges involved in the use thereof. It is implicit in all that the thing taxed in form was in fact and reality the subject aimed at, and that any burden put upon the nontaxable subject by its use as a measure of value was fortuitous and incidental."

The second case is that of *Educational Films Corporation* v. *Ward,* 282 U. S. 379, 75 L. Ed. 400, 51 S. Ct. 170, 71 A. L. R. 1226 (1931), decided in 1931, wherein this Court upheld an excise tax imposed upon corporations measured by their net income, which net income included income from copyrights.

In the *MacAllen* case the majority opinion was written by Mr. Justice Sutherland, with a dissenting opinion written by Mr. Justice Stone. In the *Educational Film Corporation* v. *Ward* the majority opinion was written by Mr. Justice Stone and the dissenting opinion by Mr. Justice Sutherland.

The latter case did not overrule the *MacAllen* case, and

further stated that the *MacAllen* case did not overrule the *Flint* v. *Stone Tracy* case.

The last case involved in this issue is *Pacific Company* v. *Johnson*, 285 U. S. 480, 76 L. Ed. 893, 52 S. Ct. 424 (1932). This opinion was written by Mr. Justice Stone and involved a corporation franchise tax of California which imposed a tax on appellant's franchise and in determining that, included in its gross income interest derived from improvement district bonds, which were tax-exempt bonds. The court upheld such franchise tax as a privilege or excise tax; held that it was not passed for the purpose of taxing property heretofore nontaxable; held that the present case was not one of discrimination.

It will be noted that in none of the three cases were banks involved, nor was the question raised as to bonds of the United States and its instrumentalities which were specifically made tax exempt as to principal and income by the Act of Congress authorizing them. The distinction apparently is a devious one and seems to require the overcoming of three hurdles: (1) the purpose of the Legislature in enacting the taxing statute seems to be fundamental; and if in truth and in fact it is a franchise tax, it is valid; or, if it is a property tax, it is invalid; (2) the question must be answered as to whether the purpose of the Legislature was to do indirectly what it could not do directly; that is, whether the Legislature was seeking to tax something that had heretofore been nontaxable; (3) the question is raised as to whether any discrimination is involved.

We submit that the legislation of the Oklahoma Legislature in enacting the 1935 Income Tax Law falls by all three of these tests.

In the first place, it is an income tax or direct tax on the income received by the bank, and not merely a franchise tax. That for the reason that the Oklahoma statutes con-

template franchise taxes on corporations in a separate and distinct manner and not taxable under the guise of the income tax law. Furthermore, the Act specifically excepts non-banking corporations. Moreover, the tax was intended as an income tax. The Oklahoma Tax Commission, the administrative commission carrying out the terms and effects of the Act, so construed it. The Supreme Court of the State of Oklahoma construed the first income tax law passed wherein national banks came within their purview, in *Board of County Commissioners of Oklahoma County* v. *Board of Equalization*, 155 Okla. 183, 8 Pac. (2d) 732, wherein the fourth and fifth syllabi read as follows:

> "Article 7, Chap. 66, Sess. Laws 1931, became effective on April 4, 1931, which provided an exclusive method of taxing banking corporations on their net income, and repealed all laws in conflict therewith; held, that said act repealed the provisions of the Oklahoma Statutes levying a tax on shares of banking corporations and substituted therefor an income tax.
>
> "Under Section 5219, R. S. of the U. S., amended March 4, 1923, Chap. 267, 42 Stat. 1499, amended March 25, 1926, Chap. 88, 44 Stat. 223 (Vol. 2, U. S. C. A. Sec. 548), providing: 'The Legislature of each state may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several states may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, provided the following conditions are complied with: 1. (a) The imposition by any state of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in subdivision (c) of this clause,' the imposing of an income tax on the next income of national banks precludes the state from levying an additional tax upon the shares of stock of national banks on an ad valorem basis."

These syllabi are written by the court and are reproduced in the body of the opinion.

Thus the Supreme Court of Oklahoma has construed these to be income taxes, and not franchise or excise taxes.

As pointed out above, and following the *MacAllen* case, which has not been overruled by this Court but, on the contrary, has been affirmed in the *Educational Films Corporation* case and in the *Pacific* v. *Johnson* case, the true purport and intent of the Legislature in changing the wording of the 1933 Income Tax Law to that found in the 1935 Income Tax Law was for the sole and only purpose of taxing income from nontaxable United States bonds.

Lastly, the Act is purely one of discrimination, both as regards bonds of the United States heretofore nontaxable, as just above set forth; as well as discriminatory against the taxpayer. Non-banking corporations by the express terms of the Income Tax Law enacted by the 1935 Session Laws are expressly excepted as regards income from nontaxable United States bonds.

We submit, therefore, that the 1935 Income Tax Law of the State of Oklahoma, insofar as it seeks to impose income taxes on income received by national banks from bonds and obligations of the United States, is unconstitutional and that said cause should be reversed. That said Act is unconstitutional and void for many reasons. It denies the equal protection of the law to the appellant for the reason that said Act is discriminatory. It discriminates against the bank in favor of other corporations in Oklahoma; likewise, it discriminates against the obligations of the United States. Said Act was passed for the sole and only purpose of to tax income from obligations of the United States, which obligations had, under prior acts, been exempted from such taxes, as the 1935 Act of the Oklahoma Legislature is a re-enactment of the 1933 Act with the only change being the inclusion of income from obligations of the United States.

Furthermore, said Act is a denial of the inherent constitutional power of Congress to borrow money on the credit of the United States, because the effect of such taxation permits the State to take all or any portion of said bonds or the income by taxation if this is permitted under the guise and manner as the Oklahoma Legislature now seeks. Furthermore, the Acts of Congress creating these obligations specifically provided that said obligations and their income should be exempt from all taxation, and this is a contract and the appellant, as the owner of such bonds, is entitled to rely thereon, and the Legislature of Oklahoma is prohibited from impairing the obligations of this contract by any subterfuge.

The only possible basis upon which the appellee may contend the law is valid is by seeking to call it a franchise or privilege tax and not as an income tax. This is contrary to the actual facts in the case and contrary to the decisions of the Supreme Court. The Legislature called it an income tax law; the administering commission, to-wit: the Oklahoma Tax Commission, denominated it an income tax law; Oklahoma has a special law with reference to franchise taxes of corporations, and banks are not included therein. Furthermore, the Supreme Court of the State of Oklahoma, in construing the predecessor Act, specifically denominated it an income tax. We submit that the Act should be declared unconstitutional and the case reversed.

E. A. WALKER,
Counsel for Appellant.

V. J. BODOVITZ,
Of Counsel.

APPENDIX "A".

Article 6.

Income Tax.

AN ACT relating to and providing for an annual tax upon the net income of individuals, corporations, estates and trusts, and an annual tax on National Banking Associations, State Banks and Trust Companies, according to or measured by their net incomes authorized by Method Four (4) of Section 5219, U. S. Revised Statutes as Amended, relating to National Banking Associations, and complying therewith, to provide revenues for general governmental functions of the State; providing for the disposition of revenues arising thereunder; prescribing the rates of such taxes; providing for specific deductions and exemptions from said tax; providing for the computation and collection of such taxes by the Oklahoma Tax Commission and empowering same to enforce said Act and to prescribe and enforce rules and regulations in relation thereto; defining the powers of said Commission in the collection of additional and delinquent taxes; making certain violations of Acts unlawful and prescribing penalties therefor; requiring income tax returns to be made by taxpayers and prescribing how same shall be prepared and filed; making said taxes and penalties a lien on taxpayers' property and providing for the enforcement thereof; requiring persons paying income to individuals to report same to said Commission; providing, in certain cases, for withholding income taxes at the source and the method of payment thereof; providing a legal remedy for aggrieved taxpayers; repealing Chapter 195, Oklahoma Session Laws 1933, and all Acts or parts of Acts in conflict with this Act, except as same apply to accrued income taxes and penalties thereon and to the collection thereof; providing that if a portion of Act is held invalid same will not affect other portions thereof and declaring an emergency.

Be It Enacted by the People of the State of Oklahoma:

SECTION 1. *Oklahoma Income Tax Law of* 1935.

The Title of this Act shall be: "Oklahoma Income Tax Law of 1935."

. . . . . .

SECTION 8. *Gross Income Defined—Exemptions—Interstate Business.*

. . . . . .

(b) Does not include the following items which shall be exempt from taxation under this Act:

. . . . . .

(4.) Interest upon the obligations of the United States or its possessions, or upon securities issued under authority of an Act of Congress, the income from which is tax-free, except as hereinafter provided:

. . . . . .

SECTION 16. *National Banking Associations.*

(a) In lieu of the tax imposed by Section 6, every national banking association located or doing business within the limits of the State of Oklahoma, shall annually, pay to this State, a tax according to, or measured by, its net income, to be computed in the manner hereinafter provided, at the following rates upon the basis of its entire net income for the next preceding fiscal or calendar year:

Six (6%) per centum of the amount of the net income as herein provided.

(b) The State of Oklahoma is hereby adopting method numbered (4), authorized by Section 5219, U. S. Revised Statutes, as amended. The tax imposed by this Section shall be exclusive and in lieu of all taxes imposed by the State of Oklahoma, or any subdivision thereof, on the property of any association liable to tax hereunder; provided, that nothing in this Section shall be construed to exempt the real property of national banking associations from taxation to the same extent, according to its value, as other real property is taxed.

(c) Any tax levied under this Section shall accrue on the first day after the close of the taxable year, as that term is defined in Section 4 (h), and the basis of the tax, according to, or measured by, the net income, shall include the entire net income from all sources to be determined by subtracting from the gross income, as defined in Section 18, the deductions allowed in Section 9.

Provided, however, that no deductions shall be allowed to any national bank or trust company for debts ascertained to be worthless and charged off within the taxable year, as defined by Section 9 (f) hereof, unless said debts actually be charged off either under the order or direction, or with the approval of the examining officials having charge of the supervision or examination of said bank or trust company.

* * * * * * *

SECTION 18. *Gross Income Defined—Interstate Business.*

(a) The term "Gross Income" includes gains, profits and income derived from the business, of whatever kind and in whatever form paid, including gains, profits or income from dealings in property, whether real or personal, or gains, profits, or income received as compensation for services, as interest, rents, commissions, brokerage or other fees or otherwise received in carrying on such business, including all dividends received on stocks and all interest received from state, municipal or other bonds or other securities, and gains, profits and income derived from any source whatsoever.

(b) The term "Gross income" shall also include the interest upon the obligations of the United States, or its possessions, or upon securities issued under the authority of an Act of Congress, the income from which is tax free.

(c) If the gross income is derived from business carried on both within and without this State, gross income means that proportion thereof which is derived from business carried on within this State, to be allocated and determined under rules and regulations to be prescribed by the Commission.

APPENDIX "B".

Chapter 195

Income Tax

House Bill No. 1

An Act providing for relief from *ad valorem* taxation by levying an annual tax upon the net income of individuals, corporations, estates and trusts; by levying an annual tax on National Banking Associations, State Banks and Trust Companies, according to or measured by their net incomes authorized by method four (4) of Section 5219, U. S. Revised Statutes as amended, relating to National Banking Associations, and complying therewith; providing for the disposition of the revenues arising hereunder; prescribing the rates of such taxes herein levied and defining terms; providing for specific exemptions to individual taxpayers; exempting religious, charitable, eleemosynary, educational, benevolent, fraternal and other corporations or organizations not organized for profit; providing for the computation and collection of such taxes by the Oklahoma Tax Commission and empowering said Commission to enforce this Act and to prescribe and enforce rules and regulations in relation thereto; defining the powers of said Commission in the collection of additional and delinquent taxes and prescribing penalties for the violation of this Act; requiri. ; returns by taxpayers and prescribing how the same shall be prepared and filed; making such taxes and penalties a lien on taxpayers' property, and for the enforcement thereof; requiring persons paying income to individuals to report same to said Commission; providing, in certain cases for withholding such taxes at the source and providing method of payment; providing a legal remedy for aggrieved taxpayers; declaring the provisions of this Act to be severable; repealing Sections 12370, 12371 and all of Article 15, Chapter 66, Oklahoma Statutes, 1931, except as to accrued taxes and penalties and the collection and enforcement thereof, and repealing House Bill Number One (1), passed by the Fourteenth Legislature of Okla-

homa, 1933, approved April 8, 1933, and all other laws in conflict herewith; and declaring an emergency.

Be it Enacted by the People of the State of Oklahoma:

Title of Act.

SECTION 1. The title of this Act shall be: "Oklahoma Income Tax Law."

* * * * * * *

Gross Income—Definition of—Inclusions and Exclusions—Exemptions.

SECTION 8. The term "gross income," except as otherwise provided in paragraph (c) of this Section,

* * * * * * *

(b) Does not include the following items which shall be exempt from taxation under this Act:

* * * * * * *

(4) Interest upon the obligations of the United States or its possession, or upon securities issued under authority of an Act of Congress, the income from which is tax-free;

National Banks—Tax in Lieu of Normal Tax—Percentums.

SECTION 16. (a) In lieu of the tax imposed by Section 6, every national banking association located or doing business within the limits of the State of Oklahoma, shall, annually, pay to the State a tax according to, or measured by, its net income, to be computed in the manner hereinafter provided, at the following rates upon the basis of its entire net income for the next preceding fiscal or calendar year:

(1) One percentum (1%) of the first $2,000 of the amount of net income in excess of the credit against net income provided in Section 11(a);

(2) Two percentum (2%) of the next $2,000 of such excess amount;

(3) Three percentum (3%) of the next $3,000 of such excess amount;

(4) Four percentum (4%) of the next $3,000 of such excess amount; and

(5) Five percentum of the next $4,000.00 of such excess amount; and

(6) Six percentum of the remainder of such excess amount.

(b) The State of Oklahoma is hereby adopting method numbered (4), authorized by Section 5219, U. S. Revised Statutes, as amended. The tax imposed by this Section shall be exclusive and in lieu of all taxes imposed by the State of Oklahoma, or any subdivision thereof, on the property of any association liable to tax hereunder; Provided, that nothing in this Section shall be construed to exempt the real property of national banking associations from taxation to the same extent, according to its value, as other real property is taxed.

* * * * * * *

Gross Income—What Included In.

SECTION 18. (a) The term "gross income" includes gains, profits and income derived from the business, of whatever kind and in whatever form paid, including gains, profits or income from dealings in property, whether real or personal, or gains, profits or income received as compensation for services, as interest, rents, commissions, brokerage or other fees or otherwise received in carrying on such business, including all dividends received on stocks and all interest received from State, municipal or other bonds or other securities, and gains, profits and income derived from any source whatsoever. Provided that the interest upon the obligations of the United States or its possessions, or upon securities issued under authority of an Act of Congress, the income from which is tax free, shall not be included in such gross income.

(b) If the gross income is derived from business carried on both within and without the State, gross income means that portion thereof which is derived from business carried on within the State, to be allocated and determined under rules and regulations to be prescribed by the Commission.

* * * * * * *